INDEX

CITATIONS

677945—46——1

In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 645

ALDRED INVESTMENT TRUST AND GORDON B. HANLON, ROBERT P. LORING, ELTON N. HANLON, W. EDWARD HIGBEE, JOHN L. ARNOLD AND MALCOLM M. BOWEN, INDIVIDUALLY AND AS TRUSTEES AND OFFICERS OF ALDRED INVESTMENT TRUST, AND EZRA D. HART, AS TRUSTEE OF ALDRED INVESTMENT TRUST, PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 1101–1114), affirming the judgment of the United States District Court for the District of

Massachusetts, is reported in 151 F. 2d 254. The opinion of the District Court (R. 100–119) is reported in 58 F. Supp. 724.

JURISDICTION

The judgment of the Circuit Court of Appeals for the First Circuit was entered on September 17, 1945 (R. 1114). The petition for a writ of certiorari was filed on December 7, 1945. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. § 347 (a)).

STATUTE INVOLVED

Section 36 of the Investment Company Act of 1940 (54 Stat. 841, 15 U. S. C. § 80a–35) provides:

> INJUNCTIONS AGAINST GROSS ABUSE
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> SEC. 36. The Commission is authorized to bring an action in the proper district court of the United States or United States court of any Territory or other place subject to the jurisdiction of the United States, alleging that a person serving or acting in one or more of the following capacities has been guilty, after the enactment of this title and within five years of the commencement of the action, of gross misconduct or gross abuse of trust in respect of any registered investment company for which such person so serves or acts:
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> (1) as officer, director, member of an advisory board, investment adviser, or depositor; or

(2) as principal underwriter, if such registered company is an open-end company, unit investment trust, or face-amount certificate company.

If the Commission's allegations of such gross misconduct or gross abuse of trust are established, the court shall enjoin such person from acting in such capacity or capacities either permanently or for such period of time as it in its discretion shall deem appropriate.

QUESTIONS PRESENTED

1. Does the evidence support the district court's finding, affirmed by the circuit court of appeals, that the officers and trustees of the petitioner investment trust have been guilty of "gross abuse of trust" within the meaning of Section 36 of the Investment Company Act?

2. Where all except one of the officers and trustees of an investment trust, including the controlling stockholder thereof, were permanently enjoined from serving as such officers and trustees upon a finding that they had been guilty of a "gross abuse of trust" within the meaning of Section 36 of the Act, did the circuit court of appeals err in upholding the district court's power to appoint receivers for the trust?

STATEMENT

The petitioners seek review by this Court of the judgment of the United States Circuit Court of Appeals for the First Circuit which affirmed a

judgment of the United States District Court for the District of Massachusetts granting in full the relief sought by the plaintiff Securities and Exchange Commission. The district court permanently enjoined each of the individual petitioners, except Hart,[1] from serving or acting in the capacity of trustee or officer of the petitioner Aldred Investment Trust, and also appointed receivers for the Trust with the power either to reorganize the capital structure of the Trust or liquidate the Trust and distribute the assets to such creditors, debenture holders, and shareholders of the Trust as may be entitled thereto (R. 96, 119).

The Securities and Exchange Commission brought this action pursuant to Sections 36 and 42 (e) of the Investment Company Act of 1940 (54 Stat. 789, 841–2, 15 U. S. C. §§ 80a–35 and 80a–41 (e)) ("the Act"), administration of which was entrusted to the Commission by Congress. Jurisdiction of this action was conferred upon the district court by Section 44 of the Act (15 U. S. C. § 80a–43). The circuit court of appeals found that the evidence supported the finding of the district court that the individual defendants who

[1] The court did not enjoin Ezra D. Hart, who joins in the petition as trustee of the Trust, because the court found that the evidence was insufficient to warrant a finding of "gross abuse of trust" by him since he did not become a trustee of Aldred until after certain misconduct on the part of the other trustees had already occurred (R. 119). Except as specifically noted, reference to the "petitioners" will mean the petitioners other than Hart.

were enjoined had, as trustees and officers of Aldred Investment Trust, been guilty of "gross abuse of trust," within the meaning of Section 36 of the Act.

A suit, referred to as the *Stratton* case (R. 1102), had earlier been instituted by certain security holders of the Trust charging the management with gross abuse and misconduct and seeking the appointment of a receiver. The record upon which the present judgment was entered consists of evidence taken both in that suit and on the Commission's application. Since the relief granted on the Commission's application was identical with that requested by the security holders, the complaint of the security holders in the *Stratton* case was dismissed without prejudice (R. 119).

Aldred Investment Trust (sometimes referred to herein as "Aldred" or the "Trust") is registered with the Securities and Exchange Commission pursuant to Section 8 of the Act (15 U. S. C. § 80a–8), and is classified under the definitions contained in Sections 4 and 5 of the Act as a closed-end, non-diversified management investment company (R. 3, 21, 100). The Trust was established by an Agreement and Declaration of Trust in 1927 as a common law trust under the laws of Massachusetts (R. 3, 21, 35, 101). The trust indenture vested in the five organizing trustees and their successors legal title to the trust

estate, absolute control, complete management and investment discretion (R. 35–66, 101). In case of vacancies the remaining trustees are authorized to appoint a successor trustee but a majority of the trustees or the holders of 25% of the common voting shares may at any time call a shareholders' meeting at which holders of a majority of the shares may supersede or re-elect the trustees in office or fill any vacancy (R. 37, 101). The trust may be terminated at any time by a written instrument signed by all the trustees although the shareholders are not empowered to end the Trust until 75 years from the date of the trust agreement or until 21 years after the expiration of numerous specified lives in being (R. 62–3, 101).

Debentures of the Trust now outstanding and held by the public amount to $5,900,000, mature in 1967, and bear interest at 4½%. To each debenture is attached one no-par value common share in the Trust for each $100 principal amount of the debenture so that 59,000 non-detachable common shares are outstanding. The Trust also issued 112,500 free common shares not attached to any debentures (R. 3, 21, 101). These were issued to Aldred and Company, investment bankers and sponsors of the Trust (R. 4, 22, 101). All common shares, whether non-detachable or free, have equal voting rights, share for share (R. 50, 102).

The purpose and declared investment policy of the Trust, until January, 1944, when the Hanlon management effected certain changes, was to invest its assets in readily marketable securities issued by public utility and industrial corporations, and the trust portfolio was made up largely of such securities (R. 102, 1004, 684–7, 628–9, 625–7, 622–3, 619–20, 616–7, 613–4, 609–10, 606–7, 867–8, 870, 872–3).

The Trust Agreement provides that no investment by the Trust shall be deemed improper because of its speculative character, or the commitment therein of an unusually large proportion of the Trust estate, or because the trustees or officers of the Trust may have an interest in, or stand to profit from, the investment (R. 44–5, 101). However, pursuant to the requirement contained in Section 17 (h) of the Act,[2] the Trust Agreement was amended on October 8, 1941 (R. 975, 980–1) to provide, *inter alia* (R. 66):

> Nothing in this Agreement and Declaration of Trust as heretofore amended shall protect any trustee or officer of the Trust against any liability to the Trust or to the

[2] Section 17 (h) required the elimination from the Agreement and Declaration of Trust of "any provision which protects or purports to protect any director or officer of such company against any liability to the company or to its security holders to which he would otherwise be subject by reason of willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his office."

> shareholders of the Trust to which he would otherwise be subject by reason of wilful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his office after October 31, 1941.

At all times since 1937 the Trust has been insolvent in that the asset value of the Trust has been substantially less than the principal amount of debentures outstanding (R. 103, 949, 891–904, 136–7, 286–7, 330, 397). In consequence the common stock has of course had no asset value since 1937. From 1940 through 1943 the Trust could not meet its interest requirements out of income. The deficiency of income for those years amounted to $479,775 out of the total interest requirements of $1,062,945. In order to prevent default on the interest payments on outstanding debentures and possible foreclosure and termination of the trust by debenture holders, capital assets were sold to make up the differences (R. 874, 876, 889–91, 893, 897, 246–262, 331–2, 193–4, 209–10).

On October, 1941, Gordon B. Hanlon (referred to herein as "Hanlon"), a securities broker and one of the petitioners, purchased a controlling block of 110,000 common unattached shares (64.11% of all common shares) of the Trust. This purchase was made at a public auction conducted on behalf of a foreclosing pledgee of shares issued originally to Aldred and Company. Hanlon paid $10,000 plus about $9,000 in transfer

taxes for the shares (R. 5, 24, 215–7). At the time of Hanlon's purchase the Trust's assets had a market value of only $2,110,000 as against $5,900,000 face amount of debentures outstanding (R. 887–8).

The conduct of Hanlon after he acquired control of the Trust and the conduct of the management he installed is discussed in the opinions of the district and circuit courts (R. 104–18, 1105–1114). The courts' findings are discussed in detail in the argument.

The court below sustained the district court's finding and the Commission's contention that Hanlon and the others enjoined with him had been guilty of gross abuse of trust. In general, the district court found that Hanlon's conduct and management of the Trust had been "calculated to further his own personal advantage" and that transactions had been made which were "motivated by self-interest" rather than the interests of the debenture holders of the Trust for which Hanlon was a fiduciary. As to the others enjoined, the court found that they aided Hanlon, participated in his activities and shared the benefits (R. 100–119).

The circuit court of appeals reaffirmed all of the district court's "detailed findings with respect to the management of the Trust" by the petitioners, which had been made "after careful

consideration of the evidence" (R. 1105) and stated, *inter alia:*

> The appellants [petitioners] challenge none of the facts upon which the decision below rested. Their objections extend only to the inferences drawn from the admitted facts to which they join the assertion that the District Court omitted consideration of certain other relevant facts which it should have taken into account. We have examined the record carefully, and in our opinion the only inferences permissible from the evidence and testimony presented at the trial are clearly to the effect that Hanlon and his associates during the period they had the management of the Trust were motivated primarily by ideas of personal gain. From the moment they took over they embarked upon a course of action which culminated in the acquisition of Eastern Racing Association. That transaction enabled Hanlon and his associates to elect themselves directors and officers of the Suffolk Downs horse-racing track, a business about which they knew nothing but which carried the certain prospect of handsome salaries (R. 1106).
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> The findings of the District Court, amply supported by the evidence, reveal a course of conduct that was motivated by self-interest and personal advantage and the calculated denial of fiduciary obligations. At no time during the period the appellants

managed the trust did the shares they relied on for control represent any equity position. The trust assets belong to the debenture holders. In effect the appellants have been using their control of other people's money to enrich themselves through the perquisites of such control. In our opinion the court below properly found them guilty of "gross abuse of trust" within the meaning of § 36 of the Act. (R. 1112.)

ARGUMENT

The petition presents "two principal questions" (see Pet. p. 5).[3] The first question and the one upon which major emphasis is placed raises merely the issue whether, as the petition states, "the evidence warrants a finding" (see Pet. p. 5) that the individual petitioners have been guilty of gross abuse of trust. The issue is purely one of fact as to which two lower courts have stated that the evidence "amply supported" the finding of gross abuse of trust (R. 1112) and indeed the circuit court of appeals stated that the finding of gross abuse of trust represented "the only inferences permissible" (R. 1106). No conflict between circuits exists and there is no rea-

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[3] One other question mentioned in the petition (see Pet. p. 6, par. (9)) is not briefed and was not mentioned in the court below. In addition, it is without merit on its face. Notice to shareholders is not necessary in a suit to remove directors for misconduct and, certainly, if it were, petitioners have no standing to complain on their behalf.

son for further review by this Court of the sufficiency of the evidence, particularly where a strong showing has been made that the evidence is overwhelming in favor of the conclusion of the lower courts. *Anderson* v. *Abbott,* 321 U. S. 349, 356.

The other question raised by the petitioners relates to the right of the district court to appoint receivers. While the question is of importance to the administration of the Investment Company Act, the decision of the lower courts is clearly correct. There is no conflict of decisions and further review by this Court is not necessary. We therefore urge that the petition for certiorari be denied.

1. The circuit and district courts properly held that the evidence fully established that Hanlon and the other enjoined petitioners grossly abused their trust. We submit that the courts below were not compelled to believe the protestations of Hanlon and the other petitioners that they acted always with a view to the best interests of the debenture holders when the evidence overwhelmingly indicated the contrary. The circuit court of appeals specifically found on this issue that "Their protestations of good faith are not borne out in the record of what they did" (R. 1107).

Briefly summarized, the findings and evidence as to Hanlon's conduct and that of the other peti-

tioners whom he controlled with respect to the management of the Trust, are as follows:

Hanlon purchased the controlling block of the stock of Aldred Investment Trust at a time when this stock was valueless, asset-wise, and would continue to be so unless and until the value of the Trust assets increased to nearly treble its value at the time of the purchase (R. 887, 888). Furthermore, the earnings of the Trust were and had been insufficient to meet the annual interest requirements on the outstanding debentures (R. 331–2). Hanlon knew these facts at the time (R. 214, 337, 338). But he also knew that these securities carried voting control of the insolvent Trust "with the attendant power," as the courts below noted, "to elect and remove trustees and officers, to fix the compensation of the latter, and to dominate completely the policies of the Trust." Hanlon's only apparent motive for the purchase was to enjoy personal emoluments of control of the $2,100,000 of trust assets. His subsequent actions confirm that this was in fact his motive.

Hanlon immediately ousted the existing board of trustees and elected as a new board of trustees and as officers of the Trust himself and certain employees, relatives and friends (R. 1105) none of whom had theretofore had any responsibility for the management of other people's funds. At all times the trustees were subject to Hanlon's

wishes and directions. Hanlon and his friends received salaries as trustees and as officers of the company. Hanlon himself was made president of the company at a salary of $5500 and later $6900 per year (R. 999, 714, 347). The office of the Trust was moved to Hanlon's brokerage office in Boston and the Trust was charged rentals of $410 per month, which were paid to Hanlon.[4] Through his salary and receipt of $4,920 per year for office space (R. 999, 714), Hanlon was able during the first two years he controlled Aldred to draw out more than the $20,000 he had paid for his controlling interest in the Trust.

With the Trust facing the threat of bankruptcy proceedings and unable to pay interest on the outstanding debentures except by sale of portfolio securities, Hanlon sought to effectuate a plan of reorganization which would relieve him of the pressure of the interest requirements of the debentures. He and his nominees in the management prepared several plans which would have left his control undisturbed but would have had the effect of making the payment of debenture interest contingent upon earnings (R. 907–13, 915, 937, 940, 997, 450–3, 569, 578–81, 150–1, 236–7, 649, 650–1, 918–36, 658, 943, 970, 662). However, when Hanlon submitted his plans to the Securities

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[4] Hanlon charged the Trust $410 per month for the use of the office space and facilities of Hanlon's brokerage firm, plus the use of one additional adjoining room for which Hanlon paid $40 monthly rent (R. 128–9, 132–3).

and Exchange Commission, the Commission took the position that any plan would be grossly unfair which did not leave the debenture holders in full control of the Trust (R. 938, 658). The Commission stated to Hanlon at the time that if he attempted to carry out his proposed plans the Commission would be forced to institute injunction proceedings pursuant to the authority vested in the Commission by Section 25 (c) of the Act to enjoin the consummation of any plan found to be "grossly unfair" (R. 911–4, 653–4, 659, 660, 664).

None of these plans was ever actually submitted to the debenture holders by Hanlon. Although Hanlon had advised the Commission that liquidation was the only feasible alternative to recapitalization (R. 908, 910, 923), no recapitalization was effected and no plan for liquidation was ever proposed. As the court below said (R. 1108):

> The District Court recited these negotiations [with the S. E. C.] as evidenciary of the conflict of interest between the appellants' concern with the perquisites of control and a proper concern for the interest of the debenture holders which dictated either reorganization or liquidation. As the court pointedly remarked: "Hanlon, since he had no equity standing in the enterprise, could not gain by liquidating, and stood to lose the more than

$10,000 per annum he was receiving from the Trust."

Unable to relieve himself of the interest requirements, the Hanlon management continued during 1942 and 1943 to sell high grade portfolio securities to pay debenture interest and management expenses (R. 1108; Pet. p. 14)[5] when serious consideration of the interests of the debenture holders would have indicated the necessity of a fair recapitalization or liquidation.

Hanlon also sought the purchase of *controlling* interests of speculative businesses. This course involved (1) the possibility of strengthening his investment position in the Trust if the speculation turned out favorably, and (2) prospects of salaries for himself and nominees in the businesses passing under the control of the Trust. He tried to purchase for the Trust control of a horse or dog track from which he could also obtain high salaries for himself and his nominees (R. 288–9).

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[5] Referring to the district court's findings with approval, the court below said (R. 1108):

"The court considered this to be a return of capital in the guise of interest. It pointed out that no technical act of default could occur so long as the appellants could sell securities and pay out the proceeds as 'ostensible interest;' that this left the debenture holders 'helpless under the terms of the debenture instrument to halt the dissipation of their assets,' and concluded that so long as the 'personal advantage' of the appellants stood in the way 'the debenture holders could not expect relief either by way of bona fide recapitalization or liquidation.' "

Hanlon and his management finally obtained an option to purchase control of Eastern Racing Association ("ERA") which operates the Suffolk Downs horse-racing track in Boston. The price paid for the controlling block of ERA stock, a total of $1,195,184, was $80 a share (R. 31, 9, 360–1), substantially in excess of the market price for small blocks of that stock which were then being bought and sold at between $50 and $60 a share (R. 507). The difference in price represented a premium paid for securing control, as Hanlon frankly admitted (R. 302, 1109).

Special premiums are sometimes paid for "control" blocks—a primary reason for this being that such control carries with it the power to designate officers and directors and fix compensation. But the debenture holders of the Trust had and have nothing to gain by the premium paid for this control—the Trust itself could not acquire offices, salaries or the like by virtue of the control. Only the individual petitioners in their private capacity could expect to benefit by such control.

Upon completion of the purchase, members of the Hanlon management promptly elected themselves directors of ERA and Hanlon was elected president (R. 762–9). The evidence is clear that Hanlon and some of his associates contemplated receiving salaries from Eastern Racing Association, some of which would be between $25,000 and

\$50,000 per year (R. 759–61, 1040–1, 1042–3; 369).

To obtain the large sum of \$1,195,184 to purchase the illiquid and highly speculative Eastern Racing stock, the Hanlon management sold large blocks of the best and most marketable securities of the company (R. 31, 9, 247–8, 250–1, 252, 253, 333, 1005, 1109). Two of these securities sold were the same securities which Hanlon had previously stated to the S. E. C. should not be disposed of hastily and in large blocks (R. 947–8, 662). Some of the shares were sold in a negotiated transaction at two points below the market (R. 278, 279).

The effects of this purchase of ERA stock were several. It involved the sale of liquid assets in order to buy frozen assets, stock which did not have a good and ready market, thus tying up the funds of the insolvent trust in a non-marketable security (R. 801, 276–9, 357).[6] The extremely speculative character of the race track stock, due largely to the industry's uncertainties because of changing public opinion and governmental regulation (R. 304, 113, 801–3),

[6] Compare the rule that a trustee must give primary consideration to the marketability of a proposed investment in the light of the probable date of termination of the Trust. See *Restatement of the Law of Trusts*, Vol. I, § 227 m, page 651. The termination of the Aldred Trust through bankruptcy was an admittedly imminent possibility. See the proposed letter to debenture holders (Pl. ex. 25, R. 662, 944).

lends further emphasis to the disregard of the interest of the public security holders. It was their money not his that was risked. Cf. *Tower Hill-Connellsville Coke Co. of West Va.* v. *Piedmont Coal Co.*, 64 F. 2d 817, 821–822 (C. C. A. 4), certiorari denied, 290 U. S. 675.

The investment in a race track, the acquisition of control of such an enterprise, the shift of 30% of the assets of the Trust from readily marketable and conservative securities to such an illiquid and speculative block of securities at a time when the Trust was insolvent was an extraordinary step involving both a radical departure from previous investment policy and a conflict of interest between Hanlon and the beneficiaries. Thus even the most open course of dealings would not justify the action taken. In any event it called for the frankest disclosure. But, as the district court stated, "Instead of fulfilling this obligation to the holders of the debentures, the defendants pursued a positive program of concealment." (R. 117.)

The investment of approximately a third of the assets of the Trust in a single company, outside the public utility industry, and the assumption of controlling functions in that company was at variance with the declared purposes of the Trust and it was necessary to obtain stockholder approval of the change. The change was voted at a shareholders' meeting upon wholly inadequate notice. The only indication was a statement in

the notice of the meeting that one of the purposes of the meeting would be "to consider and vote upon future investment policy for the Trust." (R. 591.) As the district court stated, this was "a masterful bit of understatement" (R. 117).

The district court found also that inquiries from shareholders and members of the public were avoided and evaded in order that no objection to the program of acquisition and management of the race track should be made until the racing season was over (R. 316–7, 1043–4, 778, 1046–7, 111). The elaborate precautions taken to see that investors did not discover what was happening do not bespeak a management honestly concerned for the debenture holders and attempting to do its best in the interest of those holders.

The record leaves no doubt that the petitioners enjoined had participated in all the major activities which constituted the gross abuse of trust. They voted Hanlon the salaries, the rental for office space; they approved the policy of selling assets to pay interest and expenses in order to avoid liquidation; they were fully aware of Hanlon's negotiations for the stock of Eastern Racing Association and approved the purchase of that stock; they accepted office in Eastern Racing Association. To all of Hanlon's plans they gave hearty assent and their votes were unanimous on all matters needed to effect those plans. As the court below stated: "We are not disposed to ques-

tion the conclusion of the District Court that 'at all times the trustees have been subject to Hanlon's wishes and directions'. It is apparent from the record that Hanlon's was the guiding hand and that the other appellants readily fell in with all his plans for the management of the Trust" (R. 1106). Although petitioners argue that there was no evidence to support this finding (see Pet. p. 21), it is in fact conceded that all the trustees were selected by Hanlon; that by his ownership of the controlling stock of the corporation Hanlon could oust the trustees and place into office other trustees of his choice merely by calling a new stockholders' meeting on thirty days' notice (R. 160, 206–7), a procedure he had followed in ousting the trustees who were in office before he acquired the stock of the trust. The trustees he selected owned neither stock nor debentures of the Trust and had no interest in the Trust other than their positions and the salaries paid to them (R. 125, 188, 202, 320–4). On all of the matters as to which abuse of trust was found there is no indication of any dissent on the part of any of these trustees and all votes were unanimous (see, e. g., R. 160–1, 190). The trustees-petitioners were all relatives, employees or close personal friends of Hanlon (R. 122–4, 189, 201–3).

Some mention should be made of the standard of conduct imposed on fiduciaries by the Investment Company Act. Section 36 of the Act em-

powers a district court of the United States to enjoin an officer or director of a registered investment company from acting in such capacity or capacities upon a finding that said person has been guilty of "gross misconduct or gross abuse of trust." As was properly held below, the interpretation of "gross misconduct or gross abuse of trust" as used in this section depends not only upon relevant common law principles of fiduciary duties but also upon the declarations of policy as set forth by Congress in Section 1 (b) of the Act.

In substance and as applied to this case, the standard laid down is, as the courts below held, that officers, directors and controlling stockholders of investment companies and trusts are fiduciaries and that in exercising their fiduciary capacities they are required to act in accordance with the standards generally applicable to fiduciaries. Primarily, they must manage the Trust in the interest of the beneficiaries of the Trust and not in their own personal interest. However, the Investment Company Act, while reaffirming the fiduciary standards to which managers of investment trusts are held, does not purport by Section 36 to disqualify officers and directors from further service in cases of mere technical violations of their trust, such as the making in good faith of an investment which is prohibited by the provisions of the trust or similar minor deviations from the high standards of a fiduciary. Rather, Sec-

tion 36 deals only with a "gross abuse" of trust and is intended to cover such substantial deviation from the obligations of trusteeship as would indicate that the officers and directors involved cannot be entrusted with the management of other people's money without substantial danger that the trust will be turned to the benefit of the manager rather than to the benefit of all classes of security holders. The statutory declarations of purposes in the Act (Section 1 (b)) is, as the circuit court of appeals stated (R. 1111), a codification of the fiduciary obligations imposed upon directors and officers of investment trusts. Thus, for example, Section 1 (b) (2) of the Act provides that the Act is to be construed to eliminate the evils which exist "when investment companies are * * * managed, or their portfolio securities are selected, in the interest of directors, officers, * * * or other affiliated persons thereof, * * * rather than in the interest of all classes of such companies' security holders."[7]

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[7] Other portions of Section 1 (b) provide that * * *

"It is hereby declared that the policy and purposes of this title, in accordance with which the provisions of this title shall be interpreted, are to mitigate and, so far as is feasible, to eliminate the conditions enumerated in this section which adversely affect the national public interest and the interest of investors."

and that the national public interest and the interest of investors are adversely affected

"(1) when investors * * * receive dividends upon, vote, refrain from voting, sell, or surrender securities issued

This standard as well as the substantially identical common law standard is to be considered in determining whether there has been such substantial deviation from that standard as to constitute a gross abuse of trust.

Petitioners in effect state (see, e. g., Pet. 17) that it is perfectly proper under the indenture in this case for the trustees and officers to enter into transactions on behalf of the Trust which have as their purpose the serving of their individual interests as opposed to the interests of the debenture holders. This contention, as the courts below found, is untenable. Nothing in the in-

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by investment companies without adequate, accurate, and explicit information, fairly presented, concerning the character of such securities and the circumstances, policies, and financial responsibility of such companies and their management;

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(3) when investment companies * * * fail to protect the preference and privileges of the holders of their outstanding securities;

*   *   *   *   *

(5) when investment companies, in keeping their accounts, in maintaining reserves, and in computing their earnings and the asset value of their outstanding securities, employ unsound or misleading methods, or are not subjected to adequate independent scrutiny;

(6) when investment companies are reorganized, become inactive, or change the character of their business * * * without the consent of their security holders;

*   *   *   *   *

(8) when investment companies operate without adequate assets or reserves."

denture permits such action and both ordinary standards applicable to fiduciaries and the Investment Company Act prohibit such action. See *Pepper* v. *Litton,* 308 U. S. 295, 311. In the leading case of *Carrier* v. *Carrier,* 226 N. Y. 114, 125–126, Judge Cardozo said of a trustee acting under an instrument which granted absolute and uncontrolled discretion in the matter of investment: "His discretion, however broad, did not relieve him from obedience to the great principles of equity which are the life of every trust." Had there been any doubt that fiduciary obligations could not be destroyed by language of a Trust instrument, the reiteration of those obligations by the Congress in the Investment Company Act would have resolved that doubt. *Philadelphia, Baltimore & Washington R. R. Co.* v. *Schubert,* 224 U. S. 603; *Continental Insurance Co.* v. *United States,* 259 U. S. 156.

As the evidence amply supported the findings of the courts below that Hanlon's activities and those of his associates were motivated primarily by the prospects of personal financial advantage, contrary to the interests of the debenture holders, the courts below properly found that the petitioners (except Hart) had been guilty of "gross abuse of trust" and properly held that petitioners should be enjoined under Section 36 of the Act.

2. Petitioners contend that the circuit court of appeals erred in affirming the district court's ap-

pointment of receivers even if the petitioners, except one, were properly enjoined from acting as officers and trustees of Aldred (Pet. 21–30).

The courts below found that Hanlon and most of his associates had grossly abused their trust and enjoined them from continuing as officers or trustees of the Trust. In substance, the judgment was that Hanlon and his associates could not be trusted with the management of other peoples' money. However, such an injunction alone would be thoroughly ineffective so long as Hanlon retained the controlling stock of the Trust. For an injunction which permitted Hanlon to nominate another group of trustees subject to his domination and control would merely perpetuate the situation which resulted in the abuse and might be expected to result in a repetition of the suit. The only complete and adequate remedy against the repetition of the abuses which the district court found to exist was a basic reorganization or liquidation of the Trust, so that Hanlon would no longer have control of assets which belong exclusively to the debenture holders. This could be done either by a reorganization which would wipe out the stock and place control of a new trust or corporation in the hands of existing debenture holders or by some program of liquidation which would place the assets or other proceeds in the hands of the debenture holders to whom they belong free from the influence of Hanlon. And this

is just what the district court below did. It appointed receivers for the Trust "with the power either to reorganize the capital structure of the Trust or liquidate the Trust and distribute the assets to such creditors, debenture holders, and shareholders of the Trust as may be entitled thereto" (R. 119). Petitioners' argument that no receivership is necessary is, strangely enough, based on the fact that Hanlon still owns the majority of stock and can place a new management in office (Pet. 21). To this is added the argument that Hart is not enjoined (id.). But the district court refused to enjoin Hart only because he did not become a trustee until after the Eastern Racing Association transaction was almost complete (R. 119). It was not because he was free of Hanlon's domination. Hart's continued availability does not in any way remove Hanlon's control of the voting securities or lessen the likelihood of abuse by him through Hart and other nominees not yet enjoined. Compare *Bernstein* v. *New Jersey Bankers' Securities Co.*, 156 Atl. 768, in which the New Jersey Court of Errors and Appeals affirmed a decree for the appointment of a receiver on the ground that the voting control of the corporation was in the hands of an individual who had caused the company to be mismanaged by such officers and directors as he had selected.

Petitioners, however, place their major emphasis not on the contention that a receivership is not a proper remedy for the evils found to exist, for it is indeed obvious that it is not only proper but necessary. Rather they pitch their argument on the more technical ground that even though a receivership is proper, the Commission has no standing to ask for such relief (Pet. 22 *et seq.*). But Section 36 of the Act, in giving the Commission jurisdiction to seek injunctions because of gross abuse of trust, authorizes resort to equity. And once this jurisdiction of equity has been invoked it is familiar doctrine that the court will retain the case until full justice is done and that to this end it may use all the powers inherent in a court of equity. On this point the court below rightly stated (R. 1112–3):

> Hanlon's voting control represents no equity interest in the Trust, and to permit him to remain in control would be to perpetuate the very conditions that brought about this suit. In granting relief the Distrist Court relied upon its equity power to appoint receivers with power either to reorganize or liquidate the Trust. In the light of the circumstances surrounding this case the only effective means of protecting the interests of the debenture holders was to remove Hanlon from the control of the trust assets which do not belong to him. § 36 invokes the equity power of the Federal Court and that calls into play its

inherent powers where necessary to do justice and grant full relief. The appointment of receivers in the case at bar was an appropriate exercise of the court's inherent equity power. *Graham* v. *Railroad Company,* 102 U. S. 148, 161; *Kitchum* v. *MacDonald,* 85 F. (2d) 436 (C. C. A. 3d, 1936) cert. den. 299 U. S. 595; *Tower Hill-Connellsville Coke Co.* v. *Piedmont Coal Co.,* 64 F. (2d) 817, 823 (C. C. A. 4th, 1933); *S. E. C.* v. *Fiscal Fund,* 48 F. Supp. 712 (1943). *S. E. C.* v. *Long Island Lighting Co.,* 148 F. (2d) 252 (C. C. A. 2d, 1945) relied on by the appellants, turned on a question of jurisdiction of the subject matter which question is not present in the instant case.

The petitioners place much emphasis on the opinion of the Second Circuit Court of Appeals in *S. E. C.* v. *Long Island Lighting Co.,* 148 F. 2d 252 (Feb. 23, 1945), quoting at length from the opinions of Judges Simons and Hutcheson, who constituted the majority in that case (Pet. 24–28). That case is, however, not in point. It presented the question of the jurisdiction of a federal court to give injunctive relief at the suit of the Securities and Exchange Commission pursuant to the Public Utility Holding Company Act where the relief sought was to preserve the status quo pending an administrative hearing. Whether or not the respondent was subject to regulation under the Act was contingent upon a future administra-

tive decision to revoke an exemption previously granted by the Commission. The majority opinion of Judge Simons first found inapplicable, in view of the then exempt status of respondent, the statutory provisions authorizing a Commission suit to enjoin a "violation" of the Act and then urged the absence of any authority for a federal court "to protect by injunction a jurisdiction not presently existing, merely because upon speculative and problematical circumstances, such jurisdiction may at some uncertain time in the future, arise." Nevertheless, that opinion concludes that the problem there resolved was "not free from doubt." That decision has no application to the present situation where there is no question of the jurisdiction of the court over the subject matter, where there is no question of the right of the Securities and Exchange Commission to institute suit against gross abuse of trust, and where the only question is the extent of the relief which a court of equity should grant against a proven abuse.[8]

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[8] This is not, however, to concede the authority of the *Long Island Lighting Co.* case, for we believe the dissenting opinion of Judge Clark in that case to be more cogent than the opinion of the majority judges. In support of this position we petitioned this Court for certiorari and certiorari was granted, 324 U. S. 837, March 26, 1945. After the Commission had filed its brief here, and before argument, the Long Island Lighting Company accepted a ruling of the Commission revoking its exemption, registered as a holding company, and took all steps necessary to render the case moot. Accordingly, on April 30 this Court entered the following

It is, therefore, submitted that a receivership was essential to do justice in the present case; that adequate authority exists for the appointment of receivers in such cases; and that the court had adequate power to appoint such a receiver on the application of the Securities and Exchange Commission.

CONCLUSION

For the foregoing reasons it is respectfully submitted that the petition for a writ of certiorari be denied.

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Roger S. Foster,
Solicitor,
Milton V. Freeman,
Assistant Solicitor,
Arnold R. Ginsburg,
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Securities and Exchange Commission.

January, 1946.

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order, *per curiam:* "It appearing that the cause has become moot, the judgment of the Circuit Court of Appeals is vacated and the case is remanded to the District Court with directions to dismiss the complaint."

U. S. GOVERNMENT PRINTING OFFICE: 1946